



201 N. WASHINGTON SQUARE • SUITE 810
LANSING, MICHIGAN 48933

TELEPHONE 517 / 482-6237 • FAX 517 / 482-6937 • WWW.VARNUMLAW.COM

ERIC J. SCHNEIDEWIND

E-MAIL ejschneidewind@varnumlaw.com

August 13, 2004

Ms. Mary Jo Kunkle
Michigan Public Service Commission
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909

Re: Case No. U-13720

Dear Ms. Kunkle:

Enclosed for filing in the above captioned matter please find the original and four copies of Energy Michigan's Exceptions . Also enclosed is the original Proof of Service indicating service on counsel.

Please date stamp one copy of the above entitled document for my records and return it in the self-addressed stamped envelope provided.

Thank you for your assistance in this matter.

Very truly yours,

VARNUM, RIDDERING, SCHMIDT & HOWLETTLLP

Eric J. Schneidewind

EJS/mrr

cc: ALJ
parties

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
for determination of net stranded costs)
for the year 2002 and approval of net)
stranded cost recovery charges.)
_____)

Case No. U-13720

EXCEPTIONS OF ENERGY MICHIGAN, INC.

August 13, 2004

Eric J. Schneidewind (P20037)
VARNUM, RIDDERING, SCHMIDT & HOWLETTLLP
Attorneys for Energy Michigan, Inc.
The Victor Center, Suite 810
201 N. Washington Square
Lansing, Michigan 48933
(517) 482-6237

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EXCEPTIONS OF ENERGY MICHIGAN, INC.

I. Introduction and Summary of Position

A. Introduction

These Exceptions to the Proposal for Decision ("PFD") issued by Administrative Law Judge ("ALJ") Barbara A. Stump are filed on behalf of Energy Michigan, Inc. ("Energy Michigan") by Varnum Riddering Schmidt & Howlett LLP pursuant to the schedule established by Judge Stump.

B. Summary of Position

Judge Stump claimed to base her decision on Application of U-12639 criteria which limit stranded cost recovery to costs that would have been recovered under regulation but for competition minus mitigation and stranded benefits from below market generation.

Energy Michigan excepts to Judge Stump's recommendation that Consumers be allowed to recover from ROA customers as stranded costs: 1) 2002 rate base additions above depreciation levels; 2) QF; and 3) seasonal power purchases above levels collected in frozen PSCR levels.

1. Consumers' rate base additions during the PA 141 rate freeze cannot be recovered as stranded costs using U-12639 criteria and under PA 141.

The ALJ's recommendation to include Consumers' generating rate base additions incurred after enactment of PA 141 should be rejected because:

a. None of the additions have ever been reviewed by the Commission and determined to be reasonable and prudent. Thus, they are not recoverable under regulation.

b. Collection of any of these costs below depreciation levels from any class of customers is a violation of the PA 141 § 10d(1) rate freeze.

c. To the extent that rate base additions were above depreciation levels, PA 141 § 10d(4) requires prior review and approval by the Commission for these costs to be collected from any customers.

2. Consumers' QF costs above levels collectible in frozen PSCR rates cannot be recovered as stranded costs under U-12639 and PA 141.

The recommendation of the ALJ to allow Consumers to collect \$13.7 million of QF costs above levels included in the frozen PSCR should be rejected because:

a. The costs were uncollectible under regulation because the modifications to the PSCR necessary to collect these cost from retail customers through the PSCR were rejected by the Commission in Cases U-11180R and U-12360 as a violation of the PA 141 rate freeze.

b. Collection of QF costs from ROA customers as stranded costs above PSCR levels is impermissible due to the PA 141 § 10d(1) rate freeze. Incremental QF costs do not fall within the two exceptions to that rule: costs above depreciation levels and costs caused by governmental actions, etc.

3. Consumers' seasonal power costs (and associated transmission costs) above frozen PSCR levels cannot be collected under U-12639 and PA 141.

The recommendation of the ALJ to allow Consumers to collect costs of multi-year seasonal power purchases above PSCR levels from ROA customers as stranded costs should be rejected because:

a. These costs for the most part would not be recoverable under regulation because only 92 MW of the purchases were reviewed and approved by the Commission as reasonable and prudent prior to purchase (and this review as well as the purchase took place after passage of PA 141), hence the balance of these multi-year costs would not be recoverable from retail customers through the PSCR pursuant to MCL 460.6j. See 5/11/01 entry on Tab A (Exhibit I-12).

b. Consumers did not demonstrate that these seasonal power costs were uncollectible in a competitive market due to their cost or to the offsetting mitigation of Consumers low cost generation facilities.

c. Recovery of these additional power supply costs above PSCR levels during the PA 141 rate freeze is a violation of PA 141 § 10d(1) rate freeze because these costs are not a Section 10d(4) exception to that general prohibition against rate increases.

d. While adopting Staff's recommendation to exclude the cost of single year options, neither MPSC Staff nor the ALJ removed associated transmission costs.

II. Summary of Applicable Law and Facts

A. Applicable Law

Case Law

In arriving at her PFD, Judge Stump claimed to apply the criteria for calculation and recovery of net stranded costs adopted by the Commission in Case U-12639. PFD, p. 8. Judge Stump cited

the following passage of U-12639 as describing the criteria for recovery of stranded costs as "[C]apital costs that would have been recovered under regulation that cannot be recovered under competition, offset by mitigation (such as market sales of capacity and energy that are freed up when customers choose alternative suppliers) and stranded benefits (such as generation assets with below market costs)". U-12639, December 20, 2001 ("U-12639"), p. 10. This cited passage effectively establishes three criteria for recovery of stranded costs:

- a. The cost must have been recoverable under regulation;
- b. The subject costs cannot be recovered under competition; and
- c. The cost must be offset by mitigation such as sales of freed up energy and capacity and stranded benefits such as generation assets with below market costs.

Statutory Law: PA 141

PA 141, however, establishes other specific requirements for utility recovery of alleged costs and/or alleged stranded costs.

PA 141 contains a basic requirement in Section 10d(1) which provides:

Except as provided under subsection (3) [now subsection (4)] or unless otherwise reduced by the Commission under subsection (5) [now subsection (6)] the Commission shall establish residential rates for each electric utility with 1,000,000 or more retail customers in this State as of May 1, 2000 that will result in a 5% rate reduction from the rates that were authorized or in effect on May 1, 2000. Notwithstanding any other provision of law or Commission Order, rates for each electric utility with 1,000,000 or more retail customers established under this subsection become effective on June 5, 2000 and remain in effect until December 31, 2003 and all other electric retail rates of an electric utility with 1,000,000 or more retail customers authorized or in effect as of May 1, 2000 shall remain in effect until December 31, 2003. (Emphasis supplied).

PA § 10d(1) has popularly named the "rate freeze provision". This provision has acted to prevent a utility serving more than 1,000,000 customers as is the case with Consumers Energy, from increasing any rates through December 31, 2003. Section 10d(1) must be applied notwithstanding any other provision of law or Commission Order such as U-12639.

PA 141 § 10d(4) [formerly 10d(3)] provides a means by which electric utilities such as Consumers which are subject to the PA 141 10d(1) rate freeze may collect two categories of costs above rate freeze levels.

Beginning January 1, 2004, annual return of and on capital expenditures in excess of depreciation levels incurred during and before the time period described in subsection (2) [a period prior to the time the utility meets the market test prescribed in Section 10(f) and completes transmission expansion plans] and expenses incurred as a result of changes in taxes, laws, or other state and federal government actions incurred by electric utilities during the period described in subsection (2) shall be accrued and deferred for recovery. After notice and hearing the Commission shall determine the amount of reasonable and prudent costs, if any, to be recovered and the recovery period, which shall not exceed five years, and shall not commence until after the expiration of the period described in subsection (2).

Section 10d(4) allows a utility to accrue and defer certain capital expenditures and recover them over a five year period so long as these items are capital expenditures in excess of depreciation levels incurred prior to January 1, 2004 or are expenses (such as Clean Air Act items) which are mandated by law. However, recovery of such expenditures, whether mandated by law or in excess of depreciation levels, must not occur until notice and a hearing in which the Commission determines the amount of reasonable and prudent costs if any. Section 10d(4).

A recent PFD authored by Chief Administrative Law Judge James Rigas interpreted PA § 10d(1) as it applied to a specific factual situation similar to those presented in this case. In Case U-13935 Detroit Edison asked for deferred accounting which would enable it to recover costs

related to the August 2003 blackouts which it claimed were in excess of levels recovered under its frozen rates. Judge Rigas found that the Commission was prohibited by PA 141 § 10d(1) from authorizing Detroit Edison to book the blackout costs as a regulatory asset because the Commission was prohibited from assuring recovery of these costs through future ratemaking. The ALJ stated, "The Act 141 rate freeze must be applied notwithstanding any other provision of law or Commission order. In this regard, the Legislature's intent is clearly expressed. Act 141 does provide for several specific exceptions to the rate freeze for which deferred recovery is permissible. Extraordinary expenses, whether arising from storm damage or blackouts, do not come within these limited exceptions. Staff has properly cited the tenet *expressio unius est exclusio alterius* (the express mention in a statute of one thing implies exclusion of similar things). Because Act 141 expressly identified several exceptions, any others not mentioned are excluded by implication. Blackout costs are not among the items specifically excluded from the rate freeze in Act 141." PFD, p. 10-11, July 29, 2004.

The MPSC Staff Brief in that case specifically opposed Edison's attempts to collect either directly or indirectly expenses not specifically provided for in Section 10d(4). Staff Brief, U-13935, June 11, 2004, p. 5-6.

Thus, in addition to the tests posed in U-12639 for recovery, PA 141 § 10d(1) prohibits recovery of costs incurred during the rate freeze above levels contained in frozen rates unless these cost increases are of the type covered by Section 10d(4): 1) annual return of and on capital expenditures in excess of depreciation levels which were incurred during and before 2004), or 2) expenses incurred as a result of changes in taxes, laws or governmental actions. In either case, the request for recovery must be brought to the Commission for notice and hearing and the Commission must determine the amount of reasonable and prudent costs to be recovered.

B. Applicable Facts

1. PFD

In her decision, Judge Stump recommended recovery, through stranded costs, of Consumers' 2002 power supply which were above levels recoverable from retail customers under frozen rates. These costs are related to:

- 1) Purchases from QF projects which were not included in the frozen PSCR factor applicable during the PA 141 rate freeze: \$13.7 million (PFD, p. 13-14);
- 2) Over \$8.6 million of largely unapproved multi-year seasonal power costs in excess of levels included in the frozen PSCR (PFD, p. 22-23); and
- 3) Unapproved post-2000 generating plant additions to rate base amounting to over \$12 million per year. (PFD, p. 8-10).

The impact of the PFD is to burden ROA customers with about \$33 million of costs which were largely incurred to serve retail customers after passage of PA 141. These costs are uncollectible from those retail customers, not because of competition but because of the PA 141 rate freeze.

The following facts related to these categories of additional costs are uncontested:

- 1) Consumers did not present testimony or evidence regarding the reasonableness or prudence of rate base additions or seasonal power purchases which occurred after start of the PA 141 rate freeze up to and including the 2002 period covered by this case. The rate base expenditures have never been reviewed or approved by the Commission for recovery from retail ratepayers. Only 92 MW of new seasonal capacity purchases out of 1092 MW requested were even reviewed and approved as to reasonableness and prudence.¹ This review took place after passage of PA 141 and thus the price of the PSCR factor was not increased to reflect the higher cost of these resources.

¹ U-13162, December 10, 2001.

2) Consumers did not present testimony or evidence in this case demonstrating how much of its rate base capital expenditures from June 2000 to January 1, 2004 were in excess of depreciation levels in place before PA 141. Thus, the Commission does not know how much of the post-PA 141 rate base additions were eligible for recovery under PA 141 § 10d(4).

3) Consumers did not prove that the production costs of its generation assets together with costs of power purchases (including the QF and seasonal purchases) were above market costs. On the other hand, Energy Michigan introduced testimony that Consumers' generation costs with post-PA 141 additions are at or below market levels and could offset power purchase costs. 2 Tr 215.

4) Consumers did not demonstrate compliance with Section 10d(4) requirements above depreciation levels for recovery of alleged Clean Air Act or generating plant investments nor did it prove that such investments could not have been recovered under the provisions of Section 10d(4) had Consumers complied with those requirements.

The facts in this case do show that the alleged QF cost increases of \$13.7 million and multi-year seasonal power purchase costs of over \$8 million are not recoverable from retail customers because these increases are above the amounts that will be recovered through growth in sales that will offset only the costs associated with those resources that are at or below levels contained in frozen rates (e.g. sales growth offsets increased costs at or below frozen rates but 100% of power supply costs above frozen rates would be paid by ROA customers under the Consumers proposal).

Consumers' attempt to recover increased rate base investment, increased seasonal power costs and increased QF costs all above levels collected in the frozen Consumers rates is an illegal end run around the PA 141 rate freeze and the requirements of PA 141 § 10d(4) which provide specific procedures for the collection of increased costs which are permissible exceptions to that freeze. Increases not covered by the PA 141 § 10d(4)

exceptions to the freeze are uncollectible notwithstanding any other provision of law or MPSC order.

III. Exception #1:
Stranded Costs Cannot Include Return On Capital
Expenditures In Excess Of Depreciation Levels Existing
During The PA 141 Rate Freeze Unless Such Expenditures
Have Been Determined Reasonable And Prudent

A. The Proposed Decision

The PFD recommends that Consumers be allowed to calculate stranded costs based upon rate base additions during the period 2001-2002 which are attributable to power production fixed costs above depreciation levels in effect when PA 141 was passed. PFD, p. 7. The ALJ proposed to allow Consumers to recover these costs despite the fact that this investment has not been reviewed by the Commission for reasonableness or prudence as required by PA 141 § 10d(4). The impact of the ALJ's decision is to increase stranded costs by more than \$12 million. Energy Michigan Reply Brief, see Tab C, column 6 attached.

The ALJ based her decision to include these increased generating plant investments on her interpretation of Commission Order U-12639 in which the Commission explicitly stated that, "Stranded costs would be the difference between each year's revenue requirement associated with fixed generation assets, generation related regulatory assets, and capacity payments associated with PPAs and that year's revenues available to cover those costs".

The PFD also stated, "When the revenue requirement for a specific year exceeds the revenues available to cover those costs, the utility has stranded costs for that year." December 20, 2001, Order, p. 4, PFD, p. 9.

The ALJ concluded that, "In adopting the current methodology [U-12639] it is apparent that the Commission did not intend to freeze the utility's fixed production costs at a given point in time." Id., p. 10.

Finally, the ALJ also added that she agreed with the contention of Consumers that because Retail Open Access service customers have the right to return to full service, the Company must factor in a likelihood of returning customers into its planning efforts. She concluded that her stranded cost calculation recognizes that investments in plant benefit Retail Open Access customers as well as bundled service customers. Id, p. 10.

B. Exception #1: Stranded Costs Cannot Include Return On Capital Expenditures In Excess Of Depreciation Levels Existing During The PA 141 Rate Freeze Unless Such Expenditures Have Been Determined Reasonable And Prudent

1. The Consumers Energy request to recover stranded costs related to above \$500 million of investments in generation plant made after passage of PA 141 has not met the requirements of the Commission as set forth in U-12639 or of PA 141 § 10d(4).

The passage from U-12639 quoted by the ALJ on page 8 of the PFD states that a utility is only entitled to recover such costs as would have been recovered under regulation but cannot be recovered under competition. U-12639, p. 10.

In order to obtain recovery under regulation, a utility is required to prove that the investments to be recovered were reasonable and prudent. Yet, the record in this case is devoid of any evidence or testimony by Consumers demonstrating the reasonableness and prudence of investments in production plant made after passage of PA 141. There is no record demonstrating the reasonableness or prudence of the specific rate base investments, categories of investment, alternatives or cost impact. The information to make this assessment was not provided by Consumers, the subject matter of reasonableness and prudence was not noticed to the ratepayer community at large and Consumers did not seek specific determinations on this issue.

In effect, Consumers is asking ROA customers to pay for a return on about \$500 million of investments which have never been approved for recovery from retail customers.²

² See Tab C. The difference between Consumers' requested rate base of \$1.52 billion (Col. 1) and Energy Michigan's proposed rate base of \$1.03 billion is post-PA 141 rate base additions.

As will be seen below, there is a statutory mechanism which operates even during the period of the PA 141 rate freeze, which can make Consumers whole regarding these rate base investments above depreciation or which are required by law. But even that procedure which is set forth in PA 141 § 10d(4), requires notice, hearing and a determination by the Commission that the investments were reasonable and prudent. Without these determinations, there are no provisions under State law for Consumers to obtain compensation under regulation for new capital investments in generating plant other than the revenue increase which occurs through increased sales at frozen rates.

The ALJ erred when she found that Consumers complied with the standards set forth in U-12639 at page 10. The error was that she should not have determined compliance with the U-12639 criteria when the subject investments have not been proven to be recoverable under regulation.

2. PA 141 § 10d(4) does offer a mechanism that would allow both retail customers and ROA customers to pay the reasonable and prudent costs of Consumers investments in generating plant.

Under PA 141 § 10d(4) Consumers' new generating investments which are equal to or less than the depreciation levels in effect during the PA 141 rate freeze are compensated through the frozen base rate which includes recovery of these investments. To the extent that investment must increase to accommodate increased load, the increased sales revenue may cover these costs.

To the extent that investment is above the depreciation levels in effect during the PA 141 rate freeze or investment is attributable to governmental requirements such as Clean Air Act requirements, the investments can still be recovered but PA 141 § 10d(4) requires that the utility:

- a. File notice and hearing of its intent to recover such investments after January 1, 2004;

- b. Participate in a hearing before the Commission to determine the reasonableness and prudence of the investments; and
- c. Obtain a ruling from the Commission that the investments were reasonable and prudent. PA 141 § 10d(4).

Once these steps have been taken, Consumers Energy is entitled to develop rates and collect revenues to recover the investments from its retail customers. To the extent that revenues rates do not provide full recovery, the stranded cost calculation methodology adopted in U-12639 could provide recovery from ROA customers for any balance that was unrecovered from retail customers. The Commission, however, has created an exception to this general proposition by ruling in past cases (U-13380) that Clean Air Act investments are not eligible for stranded cost recovery but are instead subject to the provisions of Section 10d(4). (Formerly 10d(3)). PFD, p. 5-6.

Thus, the Energy Michigan position that all investments above depreciation levels should be removed from rate base when calculating stranded costs until Consumers has demonstrated the reasonableness and prudence of these investments in a hearing is fully in compliance with the requirements of PA 141 § 10d(4). The conclusion of the ALJ is not.

3. The recovery of Consumers' generating plant investments during the rate freeze other than by means of the exceptions created by PA 141 § 10d(4) violates the PA 141 § 10(1) rate freeze.

In his PFD in Case U-13935, ALJ James Rigas ruled that the PA 141 rate freeze requirements must be construed strictly as applicable to all expense items incurred during the rate freeze except those categories of expense specifically enumerated in Section 10d(4): expenses above depreciation levels and expenses incurred as a result of changes in taxes, laws or state of federal governmental actions. Proposal For Decision in Case U-13935 issued by James R. Rigas July 20, 2004, p. 10-12 (the "U-13935 PFD").

This case does not contain any evidence presented by Consumers demonstrating that their non-CAA generating plant investments which were made during the period starting with passage of PA 141 and ending with the close of 2002 are above the depreciation levels in effect when PA 141 was passed. By failing to provide this vital part of its proof, Consumers has forfeited eligibility for one of the two exemptions from the PA 141 rate freeze provided by law. The PA 141 exemption allowing Consumers to collect Clean Air Act investments does not apply to ROA customers, as acknowledged by the ALJ. PDF, p. 5-6.

In effect, Consumers is attempting to do what Detroit Edison attempted in Case U-13935: incur increased expenses during the PA 141 rate freeze which are in addition to the frozen rate recovery from retail customers provided under PA 141 and then attempt to recover these increased expenses from ROA customers. To merely relabel these expense items as stranded costs rather than as a prohibited rate recovery is to engage in an end run around the basic requirements of the PA 141 rate freeze. If Consumers is allowed to increase its costs during the rate freeze and then collect those increases from any category of customers, it has made a mockery of the PA 141 rate freeze. On the other hand, if Consumers attempts to comply with PA 141 requirements regarding proof of reasonableness and prudence and, above all else, eligibility for one of the exemptions from the PA 141 rate freeze, it may be able to collect these costs from all customers not just from ROA customers.

The ALJ erred in failing to find that Consumers' request for recovery of costs related to non-CAA increased generating plant was a violation of the PA 141 § 10d(1) rate freeze.

4. Consumers failed to meet one of the criteria listed by the ALJ as deriving from U-12639: a consideration of potential stranded benefits relating to Consumers generation.

U-12639 requires that stranded benefits be applied to stranded costs (such as generation assets with below market costs). U-12639, p. 10, December 20, 2001. Energy Michigan witness Polich testified that the Consumers Energy generating fleet produces power at or

below market rates and therefore does not require a subsidy from ROA customers. This testimony was un rebutted by Consumers and the MPSC Staff. Polich, 2 Tr 215.

Consumers failed to carry its burden of proof to show that costs associated with its generation production plant are unrecoverable in a competitive market. In fact, the opposite is true. Consumers generating costs are so low that these costs are in fact recoverable in a competitive market. Mr. Polich's un rebutted Direct Testimony demonstrates this fact. Id. Thus, one of the criteria of the U-12639 test to determine stranded costs has not been met by Consumers.

5. The ALJ erred when she determined that ROA customers should pay the costs of Consumers' generating fleet because ROA customers benefit from Consumers' generating plant through the ability to return to utility service.

The ALJ's ruling was based, in part, upon Consumers' contention that recovery of its fossil plant costs from ROA customers is justified on the grounds that ROA customers can return to Consumers for tariff service and thus the plant upgrades were of benefit to ROA customers. PFD, p. 10.

However, the ALJ ignored the Energy Michigan Reply Brief which explained that the Commission may consider alternative return to service measures such as those presented by Energy Michigan in Case U-13715 which lessen the value of the return to service option and therefore justify freeing ROA customers from the burden of paying for Consumers' generating plant investments. Energy Michigan Reply Brief, p. 14-15.

The Commission should also be aware that Consumers' recent summer capacity plan filing makes it abundantly clear that Consumers has not purchased capacity nor built capacity which is sitting idle, waiting to be used by ROA customers upon returning to utility service. See Consumers Summary Capacity Plan, Energy Michigan Reply Brief, Tab B (Tab B of these Exceptions). Rather, Consumers is currently short of power as is shown by their Summer 2004 Capacity Plan. Given their shortage of generating capacity or purchased power to serve native load, it is clear that Consumers would serve returning

customers through power purchases in the open market rather than with its own generating plants which it infers are sitting idle waiting to serve returning customers. Thus, Consumers incurs no cost of standing ready to serve ROA customers. See Tab B.

C. Impact of Including Consumers Unapproved Investments in Rate Base

Tab C shows that the difference between Staff position with (Col. 5) and without (Col. 6) inclusion of Consumers' post-2000 rate base additions is worth more than \$12 million of stranded costs added to the bills of ROA customers. This modification of the PFD would lower the ALJ's recommendation to zero stranded costs.

IV. Exception #2: Qualifying Facility Costs Above Levels Collected
By The Frozen PSCR Clause Cannot Be Treated As Stranded Costs

A. The Proposed Decision

The Consumers Energy claimed revenue requirement includes \$481 million of purchased and interchanged capacity costs associated with the purchase of power from external generating sources such as Qualified Facilities, other utilities and independent generating plants. Exhibit A-4, line 7. Contained in the amount requested for recovery is approximately \$13.7 million associated with payments to the Ada Cogeneration, MCV and MPLP Cogeneration Projects which the Commission had found reasonable but refused to include in the 2002 (and 2000, 2001 and 2003) PSCR factor collected from Consumers' retail customers.

In rulings in PSCR Case U-11180R as well as a subsequent request for a new PSCR factor in Case U-12366, the Commission denied Consumers the ability to add \$13.7 million of QF costs to the PSCR factor billed to retail customers on the grounds that this increase in rates would violate the PA 141 § 10d(1) rate freeze. See U-12366, June 19, 2000, p. 2; U-11180R, July 11, 2001. Consumers did not appeal these decisions.

In this case, Consumers has based its stranded cost request upon full recovery of the \$13.7 million of QF costs from ROA customers since the amount was not recoverable from retail customers through the frozen PSCR clause.

The ALJ granted Consumers' request on the grounds that the Commission did issue an order approving these additional QF purchases as reasonable and prudent despite the fact that the amounts could not then be recovered from retail customers through the frozen PSCR. PFD, p.13-14. The ALJ also stated that rejection of Consumers' request to recover these costs only from ROA customers as stranded costs would be inconsistent with the U-12369 methodology which "...compares current revenue to current fixed costs and, therefore, it is appropriate to include these additional QF costs." PFD, p. 14.

B. Exception #2: Qualifying Facility Costs Above Levels Collected By The Frozen PSCR Clause Cannot Be Treated As Stranded Costs

Consumers has identified another category of expense (QF costs not included in the frozen PSCR) which it claims should be recovered from ROA customers because the costs cannot be recovered from retail customers. In this instance, unlike the Edison request in U-13935, it is true that the expenses were approved by the Commission as reasonable and prudent but these costs were rejected by the Commission for inclusion in the PSCR clause which was frozen by PA 141. See Case U-11180R, July 11, 2001 and U-12366, June 19, 2000, p. 2. Consumers hopes that by relabeling these incremental QF costs as "stranded costs" instead of "extraordinary expenses", it can recover the costs in violation of the PA 141 rate freeze.

The Consumers proposal to collect QF costs above frozen PSCR levels which was approved by the ALJ is a direct violation of PA 141 § 10d(1). This situation is startlingly similar to the attempt of Detroit Edison to collect "extraordinary expenses" related to the 2003 blackout in an amount that is above and beyond the frozen retail rates which were collected during 2003. In the case of Detroit Edison, ALJ Rigas determined that blackout related expenses were not one of the two specific categories of expense exempted from the PA 141 rate freeze. Therefore, he interpreted the language in PA 141 § 10d(1) and particularly the phrase "notwithstanding any other provision of law or Commission order..." as mandating exclusion of the blackout expenses

from cost recovery because collection of these cost increases would be a violation of the rate freeze. U-13935 PFD, July 29, p. 10-12.

Note that the MPSC Staff in its Brief in Case U-13935 specifically urged that the express mention in PA 141 § 10d(1) of exceptions implies exclusion of other exceptions. U-13935 PFD, p. 11. Staff Brief, U-13935, June 11, 2004, p. 4-6.

Statutory exemptions, which is what Edison is in effect asking the Commission to create in this case, are not extended beyond their plain meaning. *Grand Rapids Motor Coach v Michigan Public Service Commission*, 323 Mich 624, 36 NW2d 299 (1949). The Legislature has specifically identified the exceptions or exemptions from the rate "freeze" imposed under Act 141. Extraordinary expenses, whether due to storm damage or blackouts simply do not fall within the exceptions created by the Legislature. The maxim *expressio unius est exclusio alterius* (the express mention in a statute of one thing implies exclusion of other similar things) is applicable in this case. Act 141 expressly mentions or identifies the exceptions to the rate freeze. By expressly identifying these exceptions, the Legislature by implication excluded any others not mentioned. *Taylor v Michigan Public Utilities Commission*, 217 Mich 400; 186 NW 485 (1922), *Marshall v Wabash Ry Co*, 201 Mich 167; 167 NW 19 (1918) (a statute giving priority to personal injury judgments against railroad companies, by expressly naming liens made subordinate, by implication excludes any others not mentioned. *Id.*, p. 5.

In this case, while PA 141 expressly identified exceptions to the rate freeze including governmental mandated expenses and costs above depreciation levels, increased QF costs are not mentioned as exceptions to the PA 141 rate freeze. Thus, collection of these costs from any customer including ROA customers is expressly prohibited by the PA 141 rate freeze.

The ALJ's citations to Case U-12369 are to no avail. PA 141 § 10d(1) states that the prohibition on recovery of costs above frozen rate levels exists "...notwithstanding any other provision of law or Commission order...". Emphasis supplied. Thus, even if it were conceded that MPSC Orders authorized recovery of these QF costs above frozen PSCR levels as stranded costs, the language of PA 141 § 10d(1) specifically overrides a Commission order as well as any other statutory provision including the authority of PA 141 § 10a which authorizes the Commission to determine stranded costs.

Cost increases not included in frozen rates nor exempted from the PA 141 rate freeze cannot be recovered from Consumers customers if they are attributable to a service during the PA 141 rate freeze. The ALJ's recommendation for such recovery should be rejected for this reason.

C. Reply to QF Arguments Against Recovery of Incremental QF Costs From ROA Customers

1. QF Position

The Consumers' Initial Brief did not discuss recovery of \$13.7 million of QF costs.

Like Consumers, the Staff Initial Brief gave no reason at all for its position on recovery of incremental QF costs.

The QF and MCV Intervenors did not present testimony or evidence in this case. The QFs do not necessarily support Consumers' designation of QF costs as stranded but did argue that the Commission must allow Consumers to recover monies paid under contract to QFs. QF Brief, p. 2-7; MCV Brief, p. 1-2.

The QFs and MCV make the following arguments:

a. State law (PA 141 § 10a and § 10a(8) and MCL 460.6j(13)(b) "PA 81") and Federal law 16 USC § 2601 (PURPA) mandate that Consumers be allowed to recover all QF payments (including the \$13.7 million presented by Consumers in this case) as stranded costs. QF, p. 2-4, 5-7; MCV, p. 3.

b. The Commission orders issued prior to PA 141 show intent to allow recovery of incremental QF costs. MCV, p. 3-5; QF, p. 4-5.

2. Energy Michigan reply.

Consumers, Staff, MCV and the QFs have not made an appropriate showing under PURPA, PA 141, § 10a or 10a(8) or MCL 460.6j(13) for recovery of \$13.7 million of QF costs as stranded costs. The Commission should reject their request on the following grounds:

a. As to the QFs and MCV there has been no showing that Consumers exercised the "regulatory out" in their Power Purchase Agreements and failed to pay them for all power delivered by their projects in 2002 including \$13.7 million owed to the Ada and the MPLP projects. If the refusal of the Commission to include \$13.7 million of QF costs in the 2002 PSCR could trigger a refusal of Consumers to pay these costs to the QFs, why didn't it happen? If the QFs got paid, what is their substantive complaint? The QFs received their money two years ago. They are not credible when they claim to fear that they will not get paid.

Absent a showing that the QFs did not get paid, the Commission is entitled to assume that the QF projects were paid contracted amounts and are merely raising theoretical future concerns regarding invocation of a regulatory out clause. To repeat, there is no evidence on this record that Consumers refused to pay Ada, MCV and MPLP the \$13.7 million of increased costs despite the fact that Consumers has been denied recovery of these costs through the PSCR clause since 2000. See U-11180R, March 14, 2000; January 11, 2001 denying the QF increases and the U-12366 Order, June 19, 2000 denying resumption of the PSCR mechanism which would have allowed collection of the QF increases.

b. The \$13.7 million of QF contract costs were never allowed to be included in the PSCR factor that was frozen in June 2000. The Commission repeatedly rejected Consumers' claims that incremental QF costs which were not in the PSCR at the time of the PA 141 rate freeze (Section 10d (1)) could be recovered from retail customers. In Case U-11180R dated March 14, 2000 and July 11, 2001, the Commission rejected such requests. In Case U-12366 dated June 19, 2000 the Commission rejected reinstatement of the PSCR clause with inclusion of

the \$13.7 million of QF costs claimed in this proceeding. The reason for denial was that the PA 141 rate freeze had prevented inclusion of increased costs in the Consumers PSCR clause subsequent to June 2000. Another party appealed the U-11180R Order to the Court of Appeals and the Commission Order was affirmed. Court of Appeals, U-11180R, Case 224687, November 27, 2001. Consumers did not appeal either of these orders. The MCV was party to both cases. Numerous individual QFs were parties to U-11180R and the QF trade group (MIPPA) was a party to U-12639. None of these QFs appealed either order.

The basis of the Commission's rejection was simple, the PA 141 § 10d(1) rate freeze took effect "Notwithstanding any other provision of law or Commission Order..." That language supercedes or takes precedence over all other Michigan laws or MPSC cases cited by the QFs or MCV.

Moreover, PA 141 and PA 142 do contain mechanisms to allow full recovery of incremental QF costs after termination of the Section 10d(1) rate freeze. PA 142 allows securitization and recovery from all customers of stranded costs including above market QF costs. PA 142, § 10h(g) and § 10i(1). Consumers has not used this option.

Even if Consumers does have a Federal PURPA right to recover QF costs despite the PA 141 rates freeze, Consumers waived that right when it failed to appeal Orders U-11180R and U-12366 which rejected collection of these incremental costs during the PA 141 rate freeze.

Yet in this case, Consumers is attempting to pass along a similar rate increase to ROA customers to effectively avoid the prohibition contained in PA 141 § 10d(1) which prevented recovery from retail customers.

This case is really a collateral attack on two orders (U-11180R and U-12366) which Consumers and the numerous QF parties failed to appeal.

D. Impact of Excluding Incremental QF Costs

Exclusion of incremental QF costs from recovery as stranded costs would reduce Consumers' claimed stranded costs by \$13.7 million. See Tab C, column 4. This would reduce the ALJ's recommended \$12 million of stranded costs to negative \$1.7 million.

V. Exception #3:

Incremental Seasonal Power Purchases Above Levels Collected By The Frozen PSCR Are Not Recoverable As Stranded Costs

A. The Proposed Decision

Consumers has requested that purchases of seasonal capacity (both winter and summer) which are in addition to the purchases contained in the frozen PSCR be recovered from ROA customers as stranded costs, in part because such costs cannot be recovered from retail customers due to the PA 141 rate freeze.

The ALJ agreed with Staff's recommendation to separate these seasonal purchases into short term (single year) options or purchases and multi-year purchases. Staff's position with which the ALJ agreed is that the short term, single year purchases could be avoided but multi-year power purchase contracts are analogous to actual production plant and cannot be avoided when customers leave for Choice. Thus, the ALJ included multi-year power purchases as expenses to be covered in the Staff method of stranded cost calculation and excluded single year purchases. PFD, p. 22. However, neither Staff nor the ALJ removed the cost of associated transmission capacity when they removed the cost of single season purchases. Id.

The ALJ in part relied upon her basic interpretation of U-12639 methodology as simply comparing the revenue from a year of operations with the costs of operation and declaring the difference if negative to be stranded costs. Id.

B. Exception #3: Incremental Seasonal Power Purchases Above Levels Collected By The Frozen PSCR Cannot Be Recovered As Stranded Costs

1. Multi-year seasonal power purchases not included in frozen PSCR levels do not meet the U-12639 criteria for recovery.

a. Recoverability under regulation.

Unlike the incremental QF purchases referenced in Exception #2 above, even Consumers witness Kurzynowski testified that of the 1092 MW of proposed seasonal power contracts, only 31.3 MW were approved for inclusion in the frozen PSCR (2 Tr 158), only 58.3 MW were even purchased before the PA 141 rate freeze (Tab B, Kurzynowski workpapers) and only 92 MW of the 1092 MW were ever approved for reasonableness and prudence (in Case U-13162, December 10, 2001) which took place after the rate freeze). The rest of the power purchase contracts were not even approved by the Commission for reasonableness and prudence pursuant to MCL 460.6j(13)(b) much less for inclusion in a PSCR factor. 2 Tr 158. Also, see Tab A, (Exhibit I-12, Kurzynowski Workpaper).

Also, Consumers' request for seasonal capacity includes over \$11 million of transmission costs which were never approved by the MPSC. Exhibit A-10, line 8.

Staff witness Blair agreed that all \$43.5 million of seasonal power costs (single year and multi-year) presented by Consumers for recovery are above [not included in] the frozen PSCR which was in effect for retail customers from June 2000 through December 31, 2003 including the 2002 test year covered by this case. 2 Tr 198. Consumers witness Kurzynowski agreed with this assessment. 2 Tr 154-55.

When Consumers incurred the increased seasonal power costs including costs of transmission in the year 2002, it had not secured prior Commission review or approval of the vast majority of these expenses. When incurred, the seasonal power costs including transmission were not costs which would have been

recovered under regulation, but for competition, because the costs of multiyear power and transmission could not be recovered under regulation until they have been approved by the Commission. See MCL 460.6j(13). Thus, the basic criterion of U-12639 has not been satisfied because the vast majority of these seasonal expenses were incurred without any prior review or approval by the Commission for reasonableness. Tab A.

The record presented in this case does not contain any detail regarding the terms and conditions of these contracts or alternative methods of securing supply which would support reasonableness and prudence. Indeed, the testimony of Energy Michigan witness Richard Polich demonstrates that these expenses were not reasonable and prudent. 2 Tr 216-17.

b. Unrecoverable in a competitive market.

Consumers Energy has presented no proof that the proposed seasonal power costs including transmission were unrecoverable in the competitive market. Thus, Consumers ignored the criteria of U-12639 which state that the Commission would consider the extent to which above market costs could be mitigated or offset by stranded benefits (such as generation assets with below market costs). See U-12639, p. 10.

There is a statement by Energy Michigan witness Polich on this case record that, in fact, Consumers' generating fleet if taken as a whole has costs which are at or below market rates. These below market costs could mitigate or offset any above market costs related to specific components of that total supply portfolio. Polich Direct Testimony, 2 Tr 215. Consumers did not refute this statement.

As with Consumers' proposed QF costs and rate base cost additions, this record does not contain the detail which would enable the Commission to determine if one specific set of incremental purchases was uneconomic when averaged into the Consumers' entire supply portfolio which is economic.

2. Recovery of incremental seasonal power costs incurred during the PA 141 rate freeze is illegal.

For the reasons discussed above relating to QF costs, Consumers cannot purchase or incur power supply costs including costs of transmission during the PA 141 rate freeze which are above levels recoverable in the frozen PSCR and then avoid the PA 141 § 10d(1) prohibition on recovery simply by relabeling these items unrecoverable costs as stranded costs. This tactic is a clear violation of PA 141 § 10d(1).

The ALJ relies exclusively on her interpretation of the Commission order in Case U-12639 for approving Consumers' request to recover these increased costs which occurred during the PA 141 rate freeze. "Once again their [Energy Michigan, ABATE and Attorney General] position that all seasonal capacity should be excluded is inconsistent with the stranded cost methodology [adopted by the Commission in U-12639]. PFD, p. 22-23. "Thus, it is appropriate to include them [multi-year contract costs] in the calculation of stranded costs, because the methodology compares current revenues to current fixed production costs. *Id.*, p. 23. The Law Judge goes on to elaborate on the applicability of the U-12639 methodology to this issue. *Id.*

However, the Law Judge failed to consider that the requirements of PA 141 § 10d(1) apply "notwithstanding any other provision of law or Commission order".

The Law Judge and the Commission for that matter cannot authorize a rate increase based upon Commission orders or any other provision of Act 141 allowing recovery of cost increases incurred during the rate freeze unless those costs fit within the specific exemptions to the rate freeze enumerated in Section 10d(4): capital expenditures in excess of depreciation levels and expenses incurred as a result of changes in taxes, laws or other state or federal governmental actions. A discretionary purchase of additional seasonal capacity does not fall within either of these exemptions pursuant to the interpretation of Section 10d(1) adopted by ALJ Rigas adopted in Case U-13935, PFD, p.

10-12 which was based in large part upon the MPSC Staff's interpretation of PA 141 § 10d(4), such costs cannot be recovered because they are a violation of the rate freeze.

See also the discussion of ALJ Rigas in the U-13935 PFD re applicability of the PA 141 rate freeze to costs above frozen levels. U-13935, July 29, 2004, p. 10-12.

Summary

Inclusion of multi-year seasonal capacity purchases and associated transmission above levels contained in the frozen PSCR should be rejected for collection as stranded costs because the purchases:

- a. Do not meet U-12639 criteria since the purchases
 - i. Were unapproved by the Commission as to reasonableness and prudence;
 - ii. Have not been shown to be above market levels or to drive Consumers' total cost of power above market levels; and
- b. Because recovery of these additional costs which were incurred during the PA 141 rate freeze is a violation of that rate freeze. These costs are summarized in Exhibit A-10, line 8 and detailed in Exhibit I-12 (Kurzynowski Workpapers W-P 2, p. 1 of 1).

Even if multi-year purchases are not excluded, the Commission should order Consumers to remove transmission costs associated with single year purchases. This was not done by Staff or the ALJ.

C. Impact

Exclusion of multi-year seasonal power purchases would reduce the ALJ's recommended stranded costs by \$8.6 million plus about \$10 million of associated transmission costs. See Tab C, column 3. The ALJ's recommended stranded cost would be reduced from \$12 million to about \$2 million plus 7% interest.

VI. Conclusion and Prayer for Relief

WHEREFORE, Energy Michigan respectfully requests that the Commission adopt a final decision in this matter which incorporates the recommendations of the ALJ with the exception that:

A. Consumers rate base additions attributable to unapproved capital additions above depreciation levels incurred subsequent to 2000 should be excluded from the calculation of 2002 stranded costs; and

B. Costs associated with incremental QF purchases above frozen PSCR levels in the amount of \$13.7 million should be excluded from the calculation of stranded costs; and

C. Multi-year seasonal capacity purchases in the amount of \$8.6 million above levels contained in the frozen PSCR should be excluded from the calculation of stranded costs. If this recommendation is adopted, over \$10 million of associated transmission costs should also be removed. If only single year options are removed, then transmission costs associated with those options should be removed.

Respectfully submitted,

VARNUM, RIDDERING, SCHMIDT & HOWLETTLLP
Attorneys for Energy Michigan, Inc.

August 13, 2004

By: _____

Eric J. Schneidewind (P20037)
The Victor Center, Suite 810
201 N. Washington Square
Lansing, Michigan 48933
(517) 482-6237

Energy Michigan, Inc.

Case U-13720
Exceptions

Tab A

Energy Michigan, Inc.

Case U-13720
Exceptions

Tab B

Comparison of Summer 2004 Load and Capacity

	<u>MW</u>
Load	
Interruptible	5
Firm	8,059
Projected Peak Load Demand (MW)	<u>8,064</u>
Capacity	
Utility-Owned Generation	6,440
Non-Utility Generators	1,657
Sub - Total (MW)	<u>8,097</u>
Current Summer Capacity Plans (Power Supply Call Options, Self-Generation Contracts, Load Shift Contracts and Other Seasonal Purchases)	856
Total (MW)	<u>8,953</u>

* Assuming a nominal retail open access load of 873 MW is supplied by others.

Energy Michigan, Inc.

Case U-13720
Exceptions

Tab C

Consumers Energy
Calculation of 2002 Stranded Cost
STAFF Exhibit

Line No.	Description	[1]	[2]	[3]	[4]	[5]	[6]
		Consumers	Staff Case With Multi-Year Options and QFs Included	Staff Case Multiyear Options Excluded, QF Included	Staff Base Case Options Included & QF Excluded	Staff Case Options & QF Capacity Excluded	Energy Mich Position
Direct Costs							
1	2000 Net Production Plant	\$1,524,386	\$1,524,386	\$1,524,386	\$1,524,386	\$1,524,386	\$1,034,060
2	Pre-Tax Rate of Return	10.63%	10.63%	10.63%	10.63%	10.63%	10.63%
3	Return Required	\$162,042	\$162,042	\$162,042	\$162,042	\$162,042	\$109,921
4	Depreciation	\$56,979	\$56,979	\$56,979	\$56,979	\$56,979	\$56,979
5	Property Taxes	\$42,720	\$42,720	\$42,720	\$42,720	\$42,720	\$42,720
6	Insurance	\$858	\$858	\$858	\$858	\$858	\$858
7	PPA Capacity Charges	\$481,001	\$481,001	\$481,001	\$467,301	\$467,301	\$472,983
8	Revenue Required of Fixed Gen.	\$743,600	\$743,600	\$743,600	\$729,900	\$729,900	\$683,461
9	Net Cost of Summer Capacity (Options)	\$43,119	\$21,404	\$12,752	\$21,404	\$12,752	\$0
10	Total	\$786,719	\$765,004	\$756,352	\$751,304	\$742,652	\$683,461
12	Remove Clean Air Act Rev Req	(\$46,700)	(\$46,700)	(\$46,700)	(\$46,700)	(\$46,700)	
13	Total Revenue Requirement	\$740,019	\$718,304	\$709,652	\$704,604	\$695,952	
Fixed Generation Related Revenue							
14	Total Revenue from Sales to Ultimate Customers	\$2,411,253	\$2,411,253	\$2,411,253	\$2,411,253	\$2,411,253	\$2,411,253
15	2002 Special Contract Revenue	\$0	(\$145,749)	(\$145,749)	(\$145,749)	(\$145,749)	(\$145,749)
16	2002 Special Contract Revenue under Standard Tariffs	\$0	\$165,618	\$165,618	\$165,618	\$165,618	\$165,618
17	Tariff Based 2002 Revenue	\$2,411,253	\$2,431,122	\$2,431,122	\$2,431,122	\$2,431,122	\$2,431,122
18	Generation as Percent of Sales	29.10%	29.10%	29.10%	29.10%	29.10%	29.10%
19	Fixed Generation Related Revenues	\$701,790	\$707,573	\$707,573	\$707,573	\$707,573	\$707,573
20	From: Third Party Sales	\$190	\$190	\$190	\$190	\$190	\$191
21	Total Contribution to Fixed Generation Costs	\$701,980	\$707,763	\$707,763	\$707,763	\$707,763	\$707,764
22	Total Stranded Costs	\$38,039	\$10,541	\$1,889	(\$3,159)	(\$11,811)	(\$24,304)
23	ADD: Clean Air Act Revenue Requirement	\$46,700	\$0	\$0	\$0	\$0	\$0
24	Final Stranded Costs/(Benefits)	\$84,739	\$10,541	\$1,889	(\$3,159)	(\$11,811)	

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
for determination of net stranded costs)
for the year 2002 and approval of net)
stranded cost recovery charges.)
_____)

Case No. U-13720

PROOF OF SERVICE

Monica Robinson, duly sworn, deposes and says that on the 13th day of August, 2004 she served a copy of Energy Michigan's Exceptions in the above captioned matter upon those individuals identified in the attached service list by e-mail and regular mail at their last known addresses.

Monica Robinson, Deponent

Subscribed and sworn to before me
this 13th day of August 2004.

Eric J. Schneidewind, Notary Public
Eaton County, Michigan
Acting in Ingham County, Michigan
My Commission Expires: April 24, 2006

Service List U-13720

Jon Robinson
Consumers Energy
212 W. Michigan Avenue
Jackson, MI 49201

Don Erickson
Special Litigation Division
6th Floor, G. Mennen Williams Bldg.
525 W. Ottawa Street
Lansing, MI 48913

Bob Strong
ABATE
255 S. Woodward Avenue, 3rd Fl
Birmingham, MI 48009

Dave Voges
MPSC Staff
Mercantile Way, Suite 15
6545 Mercantile Way
Lansing, MI 48911

David E. S. Marvin
Fraser, Trebilcock, Davis & Dunlap
124 W. Allegan
Lansing, MI 48933

John Dempsey
Dickinson Wright, PLLC
101 N Main St Ste 535
Ann Arbor, MI 48104-1400